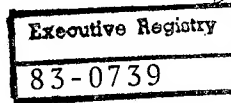




**THE SECRETARY OF COMMERCE**  
Washington, D.C. 20230



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MEMORANDUM FOR: Bill Casey

FROM: Mac Baldrige *Mac*

SUBJECT: Economic Roundup

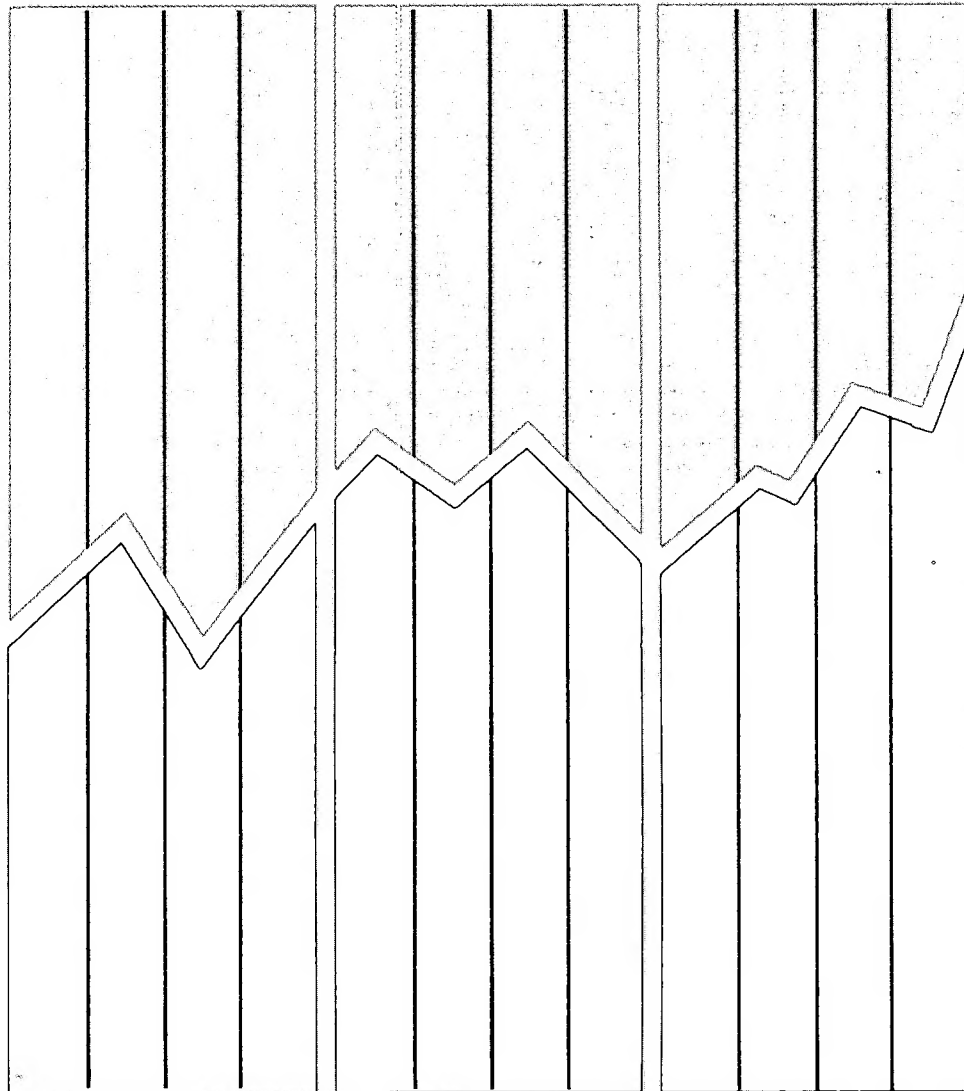
Enclosed is the January issue of our Monthly  
Economic Roundup.

Enclosure

Not referred to DOC. Waiver  
applies.



# The Economic Roundup



A MONTHLY REVIEW OF  
ECONOMIC DEVELOPMENTS



Office of Economic Affairs  
U.S. Department of Commerce

FOR OFFICIAL USE ONLY

THE ECONOMIC ROUNDUP

A Monthly Review of Economic Developments

Prepared by

The Office of the Chief Economist

U.S. Department of Commerce

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January 1983

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### SUMMARY

Though the economy apparently declined in December, it probably was close to a turning point.

- Industrial production fell slightly, after much sharper drops in October and November; declines in employment also slowed.
- Record inventory cutting last quarter reduced excess stocks throughout the economy.
- The auto and housing sectors, traditional recovery leaders, have been gathering strength, while real non-auto consumer expenditures have grown for 3 consecutive months.
- Initial claims for unemployment insurance continue the decline which began late September.
- New orders for durable goods increased in December, even excluding a surge in defense orders.
- The index of leading indicators rose 1.5 percent in December, its eighth increase in 9 months; declines in the index of coincident indicators were only marginal during the last 2 months.

Some evidence of weakness persists.

- The December advance in personal income was primarily due to government subsidies; private wages and salaries were essentially unchanged.
- The unemployment rate reached a postwar record in December, and the factory workweek was unchanged at a low 38.9 hours.
- The trade balance deteriorated in the fourth quarter of 1982, resulting in a record deficit for the year.
- The BEA survey of investment plans indicates further cuts in capital spending this year.

An upturn in production appears imminent.

- A slower rate of inventory liquidation will contribute importantly to real growth this quarter.
- The decline in interest rates late last year will be sufficient to promote further moderate gains in housing and autos.

- Non-auto consumption will grow moderately along with personal income, helped by lower inflation, interest rates and taxes.
- Defense expenditures will grow strongly, but federal non-defense and state and local government spending will be flat or down.
- Business capital spending will fall early in 1983, recovering in the second half of the year.
- Net exports will be restrained by poor economic conditions abroad, international financial dislocations, the high value of the dollar, and by the impetus of domestic growth to imports.

We project that real GNP will grow by more than 4 percent between the fourth quarter of 1982 and the fourth quarter of 1983. Inflation and interest rates probably will show little net change from their current levels.

#### ECONOMY STILL DECLINING IN DECEMBER

Most measures of current economic activity were still weak in December, and the composite index of coincident indicators slipped again, if only slightly, for the 15th decline in the last 17 months.

- The index of coincident indicators edged down 0.1-percent, a substantial slowing from the 0.8-percent drops averaged between June and November.
- Labor market conditions deteriorated somewhat further in December. Though results of the household survey were little changed from the month before, the unemployment rate and the mean duration of unemployment edged up to post-war highs of 10.8 percent and 18.0 weeks, respectively. Payroll employment, which is measured by the survey of establishments, declined another 166,000, somewhat less than the 261,000-worker average monthly setback between May and October. An increase in the automobile industry's employment helped to offset further slippage in other manufacturing industries. Mining payrolls fell 15,000, construction payrolls dropped 30,000, and less than usual hiring for the holiday selling season resulted in a 66,000-worker seasonally adjusted decline in retail trade.
- Industrial production edged down 0.1 percent in December, bringing capacity utilization in manufacturing to a postwar low of 67.3 percent. A 13.0-percent jump in auto assemblies, a 2.1-percent increase in defense production and a 2.1-percent advance in oil and gas drilling nearly offset widespread declines elsewhere.

- Personal income accelerated to a 0.6-percent rise in December following moderate gains in the two preceding months. About four-fifths of the increase was attributable, however, to subsidy payments to farmers. Private wages and salaries were little changed, as has been the case since last July.
- Real personal consumption expenditures rose 0.1 percent, after posting larger gains throughout the second half of 1982. The December slowdown from November's strong 1.1-percent advance resulted from the slackening of auto sales after their surge at the initiation of cut-rate financing. Real non-auto consumption expenditures increased 0.4 percent in December, about the same as in November.

#### DECLINE IN FOURTH QUARTER GNP ROUNDS OUT A WEAK YEAR IN 1982

Real GNP fell at a 2.5-percent rate last quarter.

- The fourth quarter drop can be attributed largely to inventory cutbacks. After modest accumulation in the third quarter, real inventories were liquidated at a record \$17.7-billion rate. Much of the reduction was in the auto industry, but every major sector of the economy cut stocks.
- Real consumption expenditures grew at a 5.0-percent annual rate, about half stemming from new car purchases. Non-auto consumption expenditures rose at a fairly strong 2.7-percent annual rate. About one-fourth of this advance, however, represented brokers' commissions on record stock market volumes.
- Real business fixed investment fell at a 9.0-percent annual rate in the fourth quarter, continuing its yearlong slide. Widespread reductions in spending on equipment were responsible for most of the decline. Expenditures for structures were little changed, as was the case throughout last year.
- Real residential investment increased at a 23.7-percent annual rate after little change during the preceding three quarters.
- A record merchandise trade deficit of \$12.8 billion in the fourth quarter was largely responsible for the decline in net exports of goods and services. Exports of autos and capital goods fell by more than the drop in petroleum imports. In addition, declining interest rates reduced net foreign investment income.
- Real government expenditures grew strongly in the fourth quarter, due almost entirely to crop purchases by the Commodity Credit Corporation. Other federal outlays, in aggregate, as well as state and local expenditures, were unchanged.

Economic performance during 1982 as a whole was poor.

- On a fourth quarter-to-fourth quarter basis, real GNP dropped a moderate 1.2 percent, while the year-to-year decline of 1.8 percent was the largest since 1946. However, a more meaningful measure is the peak-to-trough change. Real GNP fell 2.5 percent during this recession (through the fourth quarter, which we believe to be the trough), about average for the postwar period, and only about half the contraction of the 1973-75 recession.
- While some sectors have been well-insulated from the effects of the downturn, others, notably construction and durables manufacturing, have suffered greatly. This is reflected by the sectoral unemployment rates listed in the table below.

Unemployment Rates by Industry

	<u>Dec 1981</u>	<u>Dec 1982</u>
Non-farm private wage and salary workers	9.0	11.6
Construction	18.0	22.0
Manufacturing	10.8	14.8
Durables	11.6	17.1
Nondurables	9.6	11.4
Transportation and Public Utilities	6.0	8.0
Wholesale and Retail Trade	8.9	11.0
Finance and Services	6.3	7.9
Government workers	4.9	5.1

- On a fourth quarter to fourth quarter basis, real personal consumption expenditures grew 2.6 percent during 1982, despite rising unemployment and little change in real disposable per capita income.
- Business fixed investment was depressed by high interest rates, low operating rates and the drop in earnings, but housing activity recovered throughout the year.
- Inventories were cut heavily at the beginning and end of last year, while final sales grew by a marginal 0.3 percent during the year.
- A 13.1-percent decline in real exports far outweighed a 4.2-percent drop in imports. The escalating value of the dollar offset the normally favorable effect of a recession on the trade balance.
- Real government purchases rose by a strong 6.6 percent during the year. Defense outlays were up 6.8 percent. The 6.2-percent growth of federal non-defense purchases was more than accounted for by CCC purchases. Real state and local expenditures were unchanged.



- The soft economy helped to keep inflation in check during 1982. The fixed-weighted GNP price index grew by 5.0 percent, while the CPI rose only 3.9 percent during the year (the smallest December-to-December rise since 1972), and the PPI for finished goods increased by only 3.5 percent (the smallest rise since 1971). Much of last year's deceleration in inflation stemmed from reduced petroleum prices and marginal increases in food costs.
- Increases in labor costs decelerated last year. Compensation per hour (nonfarm business sector) advanced 6.6 percent, down from 8.8 percent in 1981. This slowdown, and the unusual (for a recession year) 1.9-percent growth in nonfarm business productivity, resulted in a sharp deceleration in unit labor cost increases from 8.9 percent in 1981 to 4.6 percent last year.

#### AN UPTURN IS IMMINENT

The record \$17.7-billion liquidation of real inventories last quarter suggests that stocks may now be more in line with sales and orders, and that production cuts may be behind us. If this is the case and if business firms were to hold inventories unchanged in the first quarter, the resultant production rise would contribute 4.9 percentage points (annual rate) to real growth.

- Real retail auto inventories were reduced by \$5.9 billion in the fourth quarter and represent a 2.33-month supply of cars at the current low sales rate. This is close to the 60 day inventory-sales ratio at which dealers have traditionally aimed, and further significant cuts this quarter appear unlikely. Domestic new car sales, which will be bolstered until the end of March by below-market financing, were at a 6.1 million unit annual rate in December and 6.2 million units in the first 20 days of January. Current production plans, which call for domestic assemblies of 5.8 million units in the first quarter, may be revised up if the sales pace is maintained.
- Inventory cutting last quarter was widespread. Outside the auto industry, reductions were largest for manufacturers of machinery and metals. Despite the dramatic liquidation of non-auto inventories, further sales declines meant that real inventories in the aggregate were still large relative to sales.

The 13.0-percent drop in December's housing starts followed a gain which was twice that amount the month before. Quarterly averages of starts have increased steadily for four consecutive periods. The important single-family homeownership market has been stimulated by moderate declines in mortgage interest rates since last summer, and, though sales of new single-family homes

fell 8.5 percent in December, fourth quarter sales were 30.9 percent above the preceding period. On the basis of structures already started, residential construction will contribute to first quarter growth and help to stimulate purchases of household durables as well.

#### PROSPECTS FOR GROWTH IN THE COMING YEAR

While a rebound in production, after heavy inventory liquidation, will contribute importantly to real growth, the recovery during 1983 will be determined largely by the path of final sales. Rising private credit demands will join large government demands, but interest rate pressures are not likely to develop as long as the Fed continues its support of the recovery.

- The Federal Reserve has permitted faster growth in the monetary aggregates over the last several months. The growth of M-2, at an annual rate, rose from 9.7 percent in the third quarter to 12 percent in the fourth, while the M-1 growth rate went from 8.3 percent to 16.6 percent. This apparent easing has been justified as a response to "exceptional liquidity demands" (Fed minutes for October 5, 1982) and "unusual precautionary demands" (Fed minutes for November 16, 1982). Recently, Chairman Volcker's public statements have stressed the inflationary threat of large federal deficits and the central bank's commitment to "price stability" (Fed minutes of November 16, 1982 and Chairman Volcker's speech on January 20, 1983).
- The demand for funds by households is likely to increase with rising expenditures for homes, automobiles and other consumer durables. Borrowing by corporations should be quite moderate for much of the year as capital expenditures remain weak while profits improve. Later in the year, corporate demand may pick up when inventories begin to rise again.

Sector-by-sector analysis of the economy shows that strong cross-currents remain, so that only moderate real growth this year should be expected.

- Consumer expenditures that depend on credit should expand throughout the year, though some pull-back may occur if financing rates are raised. Other consumer expenditures will grow with income. Disposable income will be boosted approximately \$35 billion by tax cuts and, perhaps, \$5 to \$10 billion by overwithholding of 1982 taxes. This increment will be partially offset by increased contributions for social insurance, new federal excise taxes and user fees, new state and local taxes, and possible reductions of uncertain size in government transfer payments.

- The BEA survey of business investment plans indicates a 5.2-percent decline in calendar 1983 spending. Assuming that this results mainly from reductions in the first half of the year, followed by moderate expansion in the second half, real business fixed investment will probably add nothing to real growth over the four quarters of 1983. As a percentage of total output, investment spending will probably drop throughout 1983, continuing its downward path of the last three years.
- Residential fixed investment will be supported by strong demographic demand in 1983. Rental housing is being stimulated by the Administration's investment incentives, and the homeownership market will grow to the extent that mortgage interest rates continue to fall. Housing starts should rise to a 1.5-million to 1.6-million unit annual rate by yearend, and residential construction will contribute \$1 billion to \$3 billion to real GNP growth each quarter.
- Real defense purchases are expected to advance about \$6 billion during the next four quarters, adding approximately 1.5 percentage points to real GNP growth over the year. Real non-defense federal expenditures may well fall as a result of budget initiatives and because the large purchases of surplus crops by the CCC at the end of 1982 are likely to be reduced in 1983. State and local government spending is being constrained by persistent budget problems and will probably not grow in real terms this year.
- To the extent that the domestic economy improves relative to economies abroad, net exports will slip further as rising U. S. spending is partially supplied by increased imports. Net exports also may be suppressed, as they were last year, by the high value of the dollar and the financial problems of LDC's (which currently purchase about 40 percent of U. S. exports.).

On balance, real GNP should grow by about 4 - 4 1/2 percent this year (fourth quarter to fourth quarter), as the swing in inventory investment, moderate increases in consumer spending and in housing, plus a hefty increase in defense purchases exceed the negative influences of business investment, non-defense government expenditures and net exports.

ECONOMIC INDICATORS

	<u>Dec</u>	<u>Nov</u>	<u>Oct</u>	<u>Sept</u>	<u>Aug</u>	<u>July</u>
<u>General Indicators (% change)</u>						
Composite Index of Leading Indicators	1.5	0.2	0.3	0.8	-0.5	1.2
Composite Index of Coincident Indicators	-0.1	-0.2	-1.5	-0.6	-0.8	-0.6
Composite Index of Lagging Indicators	-1.9	-2.0	-2.3	-1.6	-4.1	-0.5
NAPM Composite Diffusion Index (percent)	41.0	37.3	37.7	37.7	38.9	40.4
<u>Employment</u>						
Total Employment (change in 000's)	-43	-40	-367	-140	95	-93
Payroll Employment (change in 000's)	-166	-176	-407	-45	-223	-304
Unemployment (change in 000's)	130	330	261	384	103	362
Unemployment Rate (percent)	10.8	10.7	10.5	10.2	9.9	9.8
Initial Claims for Unemployment Insurance (000's)	538	615	670	671	597	515
Factory Workweek (hours)	38.9	38.9	38.8	38.8	39.0	39.2
<u>Production and Orders</u>						
Industrial Production (% change)	-0.1	-0.7	-1.1	-0.8	-0.3	0.1
Capacity Utilization, Manufacturing (%)	67.3	67.4	68.0	69.2	69.8	70.0
Auto Production (mil. units, AR)	5.4	4.4	4.3	4.9	6.6	6.6
Total New Orders (% change)	4.8	0.4	-4.1	1.2	-2.7	1.0
Nondurable Goods (% change)	-1.1	-0.4	-3.4	1.8	-0.9	-0.4
Durable Goods (% change)	11.5	1.4	-5.0	0.4	-4.6	2.6
Nondefense Capital Goods (% change)	5.1	0.0	-0.4	7.3	-7.0	5.4
<u>Inventories</u>						
<u>Manufacturing and Trade</u>						
Inventories (percent change)	NA	-1.1	-0.2	0.2	0.2	0.0
Inventory/Sales Ratio	NA	1.51	1.55	1.52	1.52	1.49
Chg. in Auto Inventories (mil. units, AR)	-0.6	-2.2	-0.8	-0.6	1.8	1.6
<u>Prices and Wages</u>						
Consumer Price Index (% change)	-0.3	0.1	0.5	0.2	0.3	0.6
Food (% change)	-0.1	0.1	0.2	0.5	-0.3	0.0
Energy (% change)	-0.6	-0.6	0.2	-0.1	0.0	1.4
All Other Items (% change)	-0.1	-0.2	0.4	0.0	0.5	0.6
<u>Producer Prices</u>						
Finished Goods (% change)	0.1	0.6	0.5	-0.1	0.6	0.5
Intermediate Goods (% change)	0.0	0.5	-0.2	0.1	-0.1	0.4
Crude Goods (% change)	-0.9	0.9	-0.7	-1.3	-0.8	-1.0
Hourly Earnings Index (% change)	0.6	0.2	0.5	0.1	0.7	0.5
Hourly Earnings Index (12-month % change)	5.9	5.7	6.2	6.2	6.5	7.1

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ECONOMIC INDICATORS (cont'd)

	<u>Dec</u>	<u>Nov</u>	<u>Oct</u>	<u>Sept</u>	<u>Aug</u>	<u>July</u>
<u>Consumer Spending and Income</u>						
Personal Income (% change)	0.6	0.4	0.6	0.2	0.1	0.9
Wages and Salaries (% change)	0.2	0.0	0.1	0.0	0.1	0.4
Disposable Personal Income (% change)	0.6	0.4	0.5	0.3	0.1	1.9
Real Disposable Personal Income (% change)	N.A.	0.3	-0.2	-0.2	-0.3	1.3
Personal Consumption Expenditures (% change)	0.3	1.1	0.7	1.1	0.4	1.0
Real Personal Consumption Expenditures (% change)	0.1	1.1	0.0	0.6	0.0	0.4
Retail Sales (% change)	-0.4	2.6	1.1	0.9	-1.1	1.6
Domestic New Car Sales (mil. of units, AR)	6.1	6.8	5.5	6.0	5.4	5.1
Saving Rate (percent)	5.8	5.5	6.2	6.3	7.1	7.4
Consumer Installment Credit (change, \$ millions)	N.A.	2523	-324	1092	66	570
Consumer Confidence Index (Conf. Board)	54.4	54.8	49.7	54.4	53.7	61.6
Consumer Buying Plans (Conf. Board)	75.4	80.5	66.7	75.3	89.0	92.0
Consumer Sentiment (U. Mich.)	71.9	72.1	73.4	69.3	65.4	65.4
<u>Construction</u>						
Real Construction Expenditures (% change)	-0.1	1.4	-0.1	-0.2	0.4	-2.2
Private Residential (% change)	3.7	4.7	3.1	-1.3	-1.5	-3.1
Private Non-residential (% change)	-3.2	0.5	-1.7	0.7	-0.6	-2.4
Public	-0.9	0.3	-0.3	-0.9	5.3	-0.3
New Home Sales (% change)	-8.5	13.1	5.3	24.8	7.7	-4.6
Housing Starts (000's of units, AR)	1222	1404	1126	1129	1033	1193
Housing Starts (% change)	-13.0	24.7	-0.3	9.3	-13.4	31.4
Housing Permits (% change)	9.5	1.7	16.8	13.0	-16.4	14.3
Mortgage Interest Rates, FHLMC (percent)	13.62	13.83	14.61	15.43	16.27	16.65
<u>Money and Credit Conditions</u>						
M1 (% change)	0.8	1.4	1.7	1.2	0.9	0.0
M2 (% change)	0.7	1.0	0.7	0.4	1.2	0.8
Federal Funds Rate (percent)	8.95	9.20	9.71	10.31	10.12	12.59
3-month Treasury Bills (percent)	8.01	8.04	7.75	8.20	9.01	11.91
Bank Prime Rate (percent)	11.50	11.85	12.52	13.50	14.39	16.26
Treasury Bond Yields (percent)	10.33	10.18	10.51	11.48	12.15	12.97
Corporate Bond Yields (percent)	12.16	11.89	12.63	13.78	14.64	15.75
Commercial and Industrial Loans (% change)	-0.8	-0.9	0.5	1.6	0.2	0.4

ECONOMIC INDICATORS (cont'd)

	<u>Dec</u>	<u>Nov</u>	<u>Oct</u>	<u>Sept</u>	<u>Aug</u>	<u>July</u>
<u>International Trade</u>						
Merchandise Exports (\$ billions)	16.3	15.7	16.7	17.4	17.5	18.0
Merchandise Imports (\$ billions)	19.7	19.8	22.0	21.6	24.6	20.4
Trade Balance, c.i.f. (\$ billions)	-3.4	-4.1	-5.3	-4.2	-7.1	-2.4
<u>National Accounts</u>						
	<u>1982</u>				<u>1981</u>	
	<u>IV</u>	<u>III</u>	<u>II</u>	<u>I</u>	<u>IV</u>	<u>III</u>
Nominal GNP (% change, AR)	1.7	5.8	6.8	-1.0	3.0	11.4
Real GNP (% change, AR)	-2.5	0.7	2.1	-5.1	-5.3	2.2
Real Disposable Income (% Change, AR)	-0.2	1.3	3.1	-1.9	1.2	4.8
Real Consumption (% change, AR)	5.0	0.6	2.5	2.5	-3.3	2.9
Real Nonresidential Fixed Investment (% change, AR)	-9.0	-7.6	-11.8	-5.0	0.6	9.3
Real Residential Fixed Investment (% change, AR)	23.7	-5.3	12.9	-10.2	-25.3	-31.9
Housing Starts (000's of units, AR)	1251	1118	952	920	865	962
Change in Business Inventories (\$72, billions)	-17.7	3.4	-4.4	-15.4	4.8	16.5
Net Exports (\$72, billions)	21.1	27.5	35.7	36.9	36.5	39.2
Real Government Purchases (% change, AR)	11.3	8.4	-5.3	-2.9	7.0	3.6
Fixed-weighted Price Index (% change, AR)	5.2	5.9	4.1	4.8	8.5	8.9
<u>Corporate Profits (% change)</u>						
Before-tax (current production)	N.A.	6.9	-1.1	-14.6	-4.8	4.3
After-tax (current production)	N.A.	5.3	-0.4	-10.6	1.4	4.5
Before-tax (book)	N.A.	5.0	0.0	-20.7	-7.2	3.5
After-tax (book)	N.A.	2.7	1.1	-20.6	-3.9	3.1

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